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REPORT OF THE SECOND ANNUAL MEETING OF THE NETHERLANDS ASSOCIATION FOR COMPARATIVE AND INTERNATIONAL INSOLVENCY LAW

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1. Introduction

The Netherlands Association for Comparative and International Insolvency Law (NACIIL, in Dutch: *Nederlandse Vereniging voor Rechtsvergelijkend en Internationaal Insolventierecht*, or *NVRIL*) decided to organize its second annual meeting on 8 November 2012 around the topic of “Corporate Rescue”. This theme has been at the heart of recent developments, such as INSOL Europe’s proposal for a European Rescue Plan and the amendment of German insolvency law as of March 2012 in order to further facilitate the restructuring of companies (*Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen*).

The main part of the programme consisted of the presentation of and discussion on the reports prepared by Stephan Madaus (professor of Civil Law, Civil Procedure and Insolvency Law at the University of Regensburg) and Robert van Galen (partner at Nauta Dutilh and member of the board of NACIIL). The meeting was chaired by Marcel Windt (partner at Houthoff Buruma).

2. Madaus - Rescuing companies involved in insolvency proceedings with rescue plans

The contribution of Stephan Madaus focused on two recommendations for the development of insolvency law. His first recommendation is to actively involve shareholders in the process of plan negotiations and voting and his second recommendation is to create a distinguished set of rules for insolvency cases initiated by the debtor by presenting a prepared or even pre-voted rescue plan, a so-called “fast track insolvency”. Madaus concluded with remarks on the latest German insolvency reform act and the ideas of INSOL Europe regarding rescue plans.

Equity interest in insolvency and reorganisation proceedings

A reorganisation plan may not only provide for a virtual sale of the debtor's business (asking creditors to agree on a fixed payoff much less than the face value of their claims), but also may involve a more sophisticated solution by providing for a restructuring of secured credit as well as the restructuring of ownership in companies (e.g. a debt-to-equity-swap). Consequently, the way to involve equity interests in insolvency proceedings has become widely discussed. Madaus points out that a modern reorganisation law seems imperfect without the ability to address this topic directly. Equity interests are often subordinated according to the absolute priority rule (APR). This gives creditors the power to make the final decision without shareholders consent.

Madaus believes there are good reasons to take another approach. If the debtor is a company and the plan provides for the impairment of equity interests, equity holders should be allowed to participate in negotiating a rescue plan and voting on a proposed plan.

If the majority of equity holders vote against such a plan, the plan can only be confirmed by a cram-down rule if it is fair and equitable by giving them a fair share of the surplus value realised by the plan. The plan should also be drawn up and negotiated in good faith. Considering creditors' rights, the best-interest-test will have to be completed. This means that no (dissenting) creditor receives a payment under the plan that is less than it would have received in a liquidation of the company in an insolvency proceeding. Besides these conditions, there is no need for a strict APR to protect creditors from equity in a reorganisation.

In reaction to a question of Yanying Li (Leiden University) Madaus clarified his view on the "fair and equitable" standard. The reorganization plan should be fair to all classes impaired. This means that the creditors should receive at least the liquidation value of the company (also known as the "best-interest-test") and that equity holders should be protected in their choice to continue the company (the "debtor's choice"). If this basic level is upheld, a plan should be held fair and equitable. Beyond that, the distribution of extra value is open to arrangements, negotiations and consent.

Madaus' proposition is based on the argument that equity interests are not part of the debtor's estate and thus not part of the creditors'

entitlement under insolvency law. While the creditors decide on the discharge of old debt, the owners of a business decide on the continuation of the business. Any reorganisation surplus value following from the continuation of the business in its contractual environment can only be realised in cooperation between the creditors and equity holders. Furthermore, there is no good reason to apply the APR in such reorganisations. Madaus argues that the APR does not fit in reorganisation scenarios, nor does it promote corporate rescue. Rather, it gives owners and management every reason to stay out of insolvency proceedings as long as they can, making reorganisation impossible in many cases.

The argument that equity interests are not part of the creditors' entitlement was questioned by Rolef de Weijs (Houthoff Buruma). In the discussion that followed Madaus stressed his view that an insolvency proceeding does not provide creditors with more rights with regard to the equity interest. Although it might be preferable to create extra value for the creditors without the possibility that equity will block this, the rights of investors deserve serious protection. As demonstrated in case law by European courts, insolvency in itself is not a reason to put the rights of equity holders aside.

In reaction to a question by Rolf Verhoeven (ABN AMRO) Madaus indicated that the participation of old equity in the reorganisation could take many shapes or forms. First, the equity holders must be willing to continue the business. Second, the aim should be to have all equity invest in the reorganisation, as well as new investors and creditors.

Xinyi Gong (Leiden University) raised the issue of considering some form of protection for potential investors in a reorganisation. In Madaus' view, special protection for new investors would be difficult to arrange. To create an incentive to invest in a reorganization one could give priorities to new investors for a limited period of time.

Fast track insolvency

The second major topic concerned the need for fast track proceedings to confirm prepared rescue plans. Madaus distinguishes the common scenario of an unprepared insolvency from the scenario of a failed out-of-court workout and prepared insolvency. A negotiated rescue plan may have the support of a majority of creditors and equity holders, but

may fail to find consensual support. According to Madaus, insolvency law should provide a regulation for both scenarios. In a failed work-out case, the rescue plan may be declared binding on every creditor or equity holder through a confirmation proceeding. Such a proceeding can be implemented as a special proceeding for work-out cases, such as the British Scheme of Arrangement, the French *procédure de sauvegarde* or the German procedure under § 5 of the *Gesetz über Schuldverschreibungen aus Gesamtemissionen*.

Madaus recommends that plan voting should take place outside of insolvency as well as outside of special court-supervised proceedings. Obtaining a majority-vote, subsequent confirmation proceedings would only consist of a confirmation hearing quickly followed by a confirmation order. To ensure fast implementation, a stay of proceedings during appeal should only be granted in exceptional cases of disproportionate and irreversible harm to a single opposing creditor, equity holder or the debtor. The task of judicial confirmation of such fast track proceedings should be assigned to insolvency courts as these courts are specialised and experienced in deciding whether a rescue plan is fair and equitable to all it will bind. Yet to prevent the stigma of insolvency, the confirmation proceedings could be called “rescue proceedings” or “confirmation proceedings”, must provide for a debtor in possession and ensure for as little interruption of the debtor’s business as possible.

German Insolvency Reform Act 2012 (ESUG) and the idea of a European Rescue Plan

Madaus then applied his thoughts on a model reorganisation law on modern German insolvency law and INSOL Europe’s proposal for a European Rescue Plan (ERP).

German insolvency law has been amended as of March 2012 in order to further facilitate the restructuring of companies. The insolvency code now provides for participation of equity in plan proceedings. To Madaus’ regret, equity holders’ vote can be overturned by creditors’ vote in a cram down based on the absolute priority rule. The reform act also improved the debtor’s chance to be appointed as debtor in possession. However, the law still does not guarantee for a debtor’s right to stay in possession during prepared insolvency proceedings as, finally and most significantly, the reform failed to introduce protection for prepared insolvency cases.

Erik Boerma (Judge with the District Court of Breda) drew attention to the current lack of reorganization plans in the Netherlands. According to Madaus, the situation has been very similar in Germany. The total number of reorganization plans has been low and recent reform aimed to raise these numbers. So far however, most corporate rescues have been realized through a going concern liquidation sale by auction.

Madaus concluded his presentation with a brief remark on INSOL Europe's proposal for a European Rescue Plan to be added to a revised version of the European Insolvency Regulation. Although Madaus supports the basic idea of such a rescue plan, he is opposed to applying the absolute priority rule against equity interest in the case of a reorganisation plan. Furthermore, the proposal should waive unnecessary court hearings, allow voting in writing and restrict the staying effect of appeals for all jurisdictions. Moreover, the proposal should allow fast track proceedings with little effect on debtor's business and management in prepared cases, while providing for full administration in prepared cases.

3. Van Galen - Insolvent groups of companies in cross border cases and rescue plans

The presentation of Robert van Galen mainly concerned two topics. Firstly, Van Galen described five different regimes and four different scenarios of dealing with group insolvencies within the European Union. Secondly, Van Galen addressed the European Rescue Plan as proposed by INSOL Europe. As a preliminary remark Van Galen pointed out that the situation in the European Union is somewhat special. On the one hand, there is the principle of community trust, which under the European Insolvency Regulation entails that member states should trust decisions taken by courts in other member states. In this regard, there is a difference with cross border cases where there no such trust exists. On the other hand the EU situation differs from a domestic situation because a COMI is designated which may cause a shift in the law applicable to the insolvency.

Five regimes of dealing with group insolvencies

Van Galen started by distinguishing five different regimes of dealing with group insolvencies. The first regime is based on *coordination between courts*. Although there are several sets of rules and guidelines on coordination, it is still a rather weak instrument. It can easily be overruled by national laws and cannot overcome the problem that

trustees of subsidiaries may exploit hold out positions in the interest of their own creditors. The second regime is based on *coordination powers for the trustee of the main proceedings*. It is required that one of the proceedings is designated as the group main proceedings, probably that of the parent company. The trustee of the main proceedings has powers in the subsidiaries' insolvencies. The court of the subsidiary probably decides on such requests. This is the regime favored by INSOL Europe. The third regime consists of the *appointment of a mutual trustee in all group proceedings*. This may be an efficient option, but there are some disadvantages in the sense that conflicts of interest between the companies within the group would have to be handled by one and the same liquidator. Also, the mutual trustee might have to deal with different laws, languages and legal cultures which may hinder effective communication with the courts. Therefore, it should not be the standard solution according to Van Galen. The fourth option is a *joint administration regime*. If this would entail that the law of the bankruptcy court applies, there would be a shift in the law applicable to the insolvency proceedings of the individual companies of the group. On the other hand, applying the law of the individual subsidiaries would burden the court. The fifth and final regime is based on *substantive consolidation*. All the assets and liabilities will be thrown on a pile and are no longer attributed to individual companies. The general view is that this should rather be the exception than the rule.

Van Galen then elaborated on the second regime of the liquidator with coordinating powers. Under such a regime four restructuring scenarios are possible according to Van Galen. A *coordinated asset sale* by the individual group companies provides the first scenario. The trustee with coordinating powers can, for example, ask the court of the subsidiary proceedings to suspend any asset sale by the trustee of the subsidiary. The former can then try to agree on a coordinated sale with the trustees of the individual companies. However, it might be difficult to align all trustees and courts in the various insolvencies of companies of the group. A second scenario is a *coordinated rescue plan* with respect to the individual group companies. For example, the liquidator of the group main proceedings can propose rescue plans in all subsidiary proceedings. This might be very difficult to achieve and serious limitations may be posed by national law. A third option. The liquidator of the parent company would have the power to sell all or part of the assets of the group. There may however be conflicts of interests between (creditors of) the different group companies. A final

scenario is one *consolidated plan* for the whole group. The proposal for the European Rescue Plan (ERP) by INSOL Europe is based on this idea.

European Rescue Plan

The European Rescue Plan is a specimen of a consolidated plan for the whole group of companies in different jurisdictions. Adoption of the plan takes place under the supervision of the court of the main proceedings of the parent company. Under the ERP, creditors are placed in classes and each class votes on the plan. The interests of the different classes should essentially be the same. If all classes accept the plan, the court will confirm the plan. If a creditor opposes confirmation, the court will still confirm, unless:

- i. the plan unfairly favors one or more creditors, or
- ii. the creditor receives less value than he would receive in a liquidation (the best interest test), or
- iii. the plan is not feasible.

If one or more classes do not accept the plan, the court will decide on a cram down. INSOL Europe has accepted the absolute priority rule in this respect. From this rule follows that no cram down may take place if a lower ranking creditor would receive anything under the plan whilst a higher ranking creditor does not receive full value (he is “impaired”). However the meaning of this rule is limited because with respect to different creditors of different companies, it is not possible to say that one creditor is higher ranking than another. Therefore, a rule has been added that a rejection by a class can only be overruled if the rejection was not in good faith.

The procedure of the ERP has three stages. In short, first the trustee of the group main proceedings submits the plan, an information memorandum and the class schedule to the court. This is followed by an acceptance hearing. The court decides on recognition of the claims that are disputed and it will establish a definite class schedule. After that, creditors will vote on the plan. With respect to creditors that have rejected the plan, the court will decide on cram down. As a third stage, the court will confirm the plan unless a creditor or shareholder opposes confirmation. The court will then apply the best interest test, the feasibility test and the test whether the plan unfairly favors one or more creditors or shareholders.

Van Galen then responded to the objections to the ERP raised by prof. Madaus. First and foremost, Madaus is of the opinion that the APR should not only be absent at the confirmation test (as it is under the ERP), but also at cram down. This would enable equity's involvement. However, according to Van Galen, the fact that the APR is absent when a class accepts the plan gives the different classes enough opportunity to bargain over any surplus value. In Van Galen's view, in insolvency proceedings equity is absent and it is up to the creditors to decide whether equity is still allowed to retain something. The fact that the creditors are placed in classes that have more or less the same interest justifies this. The question whether the court will overrule a rejecting class must be seen in the key of abuse of right. In a group of companies it can be hard to establish a ranking order between the creditors, so then the court must apply the test whether the rejection is in good faith.

In response to Madaus' submission that one (confirmation) hearing is sufficient, Van Galen explained that eliminating the acceptance hearing would imply that the court would decide on classification after knowing the outcome of the voting. This could sway the court towards a more plan-friendly attitude.

The role of equity

Marcel Windt and Reinout Vriesendorp (Tilburg University and De Brauw Blackstone Westbroek) asked prof. Madaus whether he had taken the economic perspective into account when proposing to give shareholders a permanent role in a reorganization. Prof. Madaus explained that in his view, the economic perspective is a too one-sided view on a reorganization. There is no justification not to apply the legal rules outside of insolvency to the company in a reorganization. This is confirmed by the European Court of Justice, as well as the German Bundesverfassungsgericht, who would judge that the membership rights of shareholders have to be considered, even if they are out of the money, as they are protected by the constitution or EU directives.

Rolef de Weijs brought up the question whether the fact that equity brings new value to the company is a prerequisite for equity to be allowed to keep some value. Also, De Weijs asked if it was indeed the case that under present German law, equity does not have any bargaining power. Madaus explained that it is not a condition for equity

to bring value to the table. In his view, there should not be a cram down only because equity is out, but that instead the fair and equitable test should be applied. If a cram down is in accordance with the fair and equitable standard, the dissent of equity can be overturned by a judge.

The role of the judiciary

Erik Boerma was wondering how the many courts in Europe can be coordinated. When applying the ERP, how can we make sure that every court in the European Union would decide in the same manner and how are these decisions made accessible? Robert van Galen answered that the trustee of the parent company has certain powers with respect to the subsidiaries. He can propose a group plan, but no proposals for coordination between courts are included in there. The reason for that is that a group of INSOL Europe is still discussing this matter. It would be harder to attain than the ERP, because the latter only applies in a limited number of cases, namely group cases in multiple jurisdictions. Therefore a plan for coordination between courts has not been put forward by INSOL Europe up until now.

The future of the ERP

Bob Wessels (Leiden University) then posed a practical question to each of the day's speakers: the first about the chances of success of the ERP to make it through the European Commission, and the second on the success of reorganization plans in Germany so far. Madaus answered to the second question that there were no numbers yet, because the new law (ESUG) has only been in force for six months. So far, the two cases that he is aware of regarded small family businesses. It is expected that in January or February 2013 the first results of the insolvency plans will be published by the courts. In response to the first question Van Galen answered that INSOL Europe opted to draft provisions that represent the best way forward. INSOL Europe preferred to start the debate about the optimal solution for a European plan rather than not have a debate at all. If the proposal will not make it into legislation this time, it may be taken into account in the next round, regarding the fact that the Commission has to evaluate the regulation every five years.

On 12 December 2012, not long after the annual meeting of the NACIL, the European Commission published its proposal for amending the European Insolvency Regulation. The Commission has not adopted INSOL Europe's suggestion for a European Rescue Plan.

Rather, the proposal focuses on a regime of intensified coordination and communication between courts and liquidators in case of an insolvency of a group of companies.⁸³

4. Concluding remarks

The need for fast track corporate rescue proceedings and a solution for cross-border insolvencies of groups of companies is clear. The future developments of this area of insolvency law are both challenging and exciting. Prof. Madaus and Van Galen provided the NACIIL with valuable reports on corporate rescue and the cross-border reorganization of groups of companies. Their presentations and the lively debate that followed formed the heart of another successful annual meeting of the NACIIL.

⁸³ See the proposal for amending Council Regulation (EC) No 1346/2000 on insolvency proceedings, 2012/0360 (COD), Chapter IVa, Article 42a ff.